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TO: Supervisor Don Knabe, Chairman
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FROM: J. Tyler McCauley 
Auditor-Controller

SUBJECT: **COST OF REQUIRING COUNTY PERSONNEL TO APPROVE
CONTRACTOR AUTHORIZED PAYMENTS (AGENDA ITEM #2, JULY
29, 2003)**

In response to a payment fraud involving the GAIN Employment Activity and Reporting System (GEARS), on July 29, 2003, your Board instructed the Director of the Department of Public Social Services (DPSS) to modify the GAIN Employment Activity and Reporting System (GEARS) to require that two County employees approve all contractor authorized payments. Your Board also instructed the Auditor-Controller to report back to the Board with the cost of implementing this recommendation and possible alternatives, and the impact if the policy is not adopted. This is our report.

Background

DPSS currently contracts with the Department of Community and Senior Services (DCSS) to provide case management services to non-English/Spanish speaking participants under the Refugee/Immigrant Training and Employment (RITE) program. DCSS in-turn subcontracts with 11 community based organizations (RITE Providers) that provide the actual case management services to participants. DCSS is responsible for the administration and monitoring of the RITE program on behalf of DPSS. DPSS also contracts with MAXIMUS and ACS State and Local Solutions (ACS) (formerly Lockheed Martin – IMS) to provide case management services to English/Spanish speaking participants under the Greater Avenues for Independence (GAIN) program. DPSS is directly responsible for the administration and monitoring of the contracts with MAXIMUS and ACS.

Both the RITE providers and the contract GAIN providers have the ability to authorize participant payments for transportation, ancillary costs and child care on DPSS'

GEARS. To issue payments, GEARS' internal control system requires varying levels of supervisory/management approval based on the dollar amount of the participant payment. County personnel have no direct involvement in authorization or approval of these benefit payments.

During the Fiscal Year 2002-2003, the RITE Providers issued approximately 76,000 warrants for transportation and ancillary payments totaling approximately \$4.5 million. Approximately 82,000 transportation and ancillary payments warrants totaling approximately \$6.75 million were issued by MAXIMUS and ACS for the same period.

Summary

Of the three alternatives identified, Option #1, which would require pre-approval of all payments by two County employees, is the strongest from an internal control (i.e., safeguarding of assets) perspective. However, as was expected, it is also the most expensive, costing approximately \$701,000 for the GAIN Program and approximately \$1.19 million for the RITE Program. The least costly alternative is Option #3, which would only require an after payment review by a County employee of a 20% sample of payments. Option #3 would cost approximately \$63,000 for the GAIN Program and approximately \$98,000 for the RITE Program.

It should be noted that both the RITE and GAIN contracts are Proposition A contracts and their original estimated cost savings were due in some part to not having internal controls such as adequate County approvals over contractor authorized payments. In retrospect, we believe that the cost savings previously identified for these programs were overstated because the estimates of contractor cost did not consider the additional costs that would be necessary to address the internal control weaknesses that allowed the payment fraud to occur.

GAIN – Recommended Action

The annual Proposition A cost savings estimates for the GAIN Case Management contracts with MAXIMUS and ACS average \$1.15 million and \$1.45 million, respectively. If the increased costs of implementing Option #1 are factored in, the GAIN contracts are still significantly cost effective. Because of the need to ensure that funds are properly spent, the fact that Option #1 provides for the highest level of security over DPSS payments, and because these agreements continue to provide substantial cost savings assuming the implementation of Option #1, the Auditor-Controller favors implementation of Option #1 for the two GAIN Program contractors.

If the DPSS decides to not implement Option #1 due to its cost, it must ensure that payments previously monitored by DCSS, are diligently monitored on an ongoing basis using one of the two other options. On the positive side, it is acknowledged that DPSS has otherwise strengthened internal controls over the GEARS payments. For example, previously, if payments were below a certain dollar threshold, approval by only one

contractor personnel was required to generate a payment. Currently, at least two individuals must approve all payments.

RITE – Recommended Action

The annual Proposition A cost savings estimate for the RITE Program are approximately \$51,000 annually. These savings are marginal, less than 1% of the annual estimated cost of this program of \$8.3 million. As the data on Table 2 on page 6 indicates, implementation of any of the three options under consideration would result in the agreement for the RITE Program no longer being cost effective.

To date, in conjunction with its investigation of the payment fraud involving RITE contractors, the District Attorney's office has identified almost 5,400 payments totaling in excess of \$844,000 which may ultimately be identified as fraudulent issuances. The dollar value of the County payments under investigation is in excess of sixteen times the estimated annual cost savings of contracting for the RITE Program. DCSS recently exercised an option to extend the existing agreements with the RITE contractors through June 30, 2004.

Because of the marginal initial savings estimates, these contracts are not cost effective when the additional costs of theft, or achieving adequate controls are taken into account. When the contracts are re-bid and a new savings analysis is performed, DPSS should ensure that included in the cost of contracting are the costs of adequate internal controls (i.e., Option #1). In the meantime, DPSS and DCSS should continue to actively monitor RITE contractor payments. Together with the improved GEARS controls, this should provide adequate short-term fraud prevention.

Results of Review

Cost of Approving Contractor Authorized Payments

Methodology

In developing the estimates of avoidable cost, it was assumed that County personnel would be approving and/or monitoring payments authorized by both GAIN contractors (i.e., MAXIMUS and ACS) and the RITE providers. The estimates were developed in conjunction with DPSS and include Salaries and Employee Benefits of the personnel that would perform the actual reviews and approvals, as well as other relevant costs such as the cost of clerical support, section management and supervision, services and supplies costs, bilingual bonuses, etc. In developing the estimates of cost, we employed the guidelines that are utilized in a Proposition A cost analysis, under which only costs that are deemed "avoidable" are considered.

In determining the number of DPSS personnel required to perform the payment approval and monitoring tasks, estimates of average case review times had to be used because these functions are not currently performed by the County. To develop these

estimates. DPSS arranged for simulations of payment review and approval activities to be conducted by Departmental personnel under our observation. DPSS then arranged for personnel from one of the GAIN Case Management contractors to perform timed review and approval simulations on the same transactions. The overall average review times of the contractor were consistent with those noted for County personnel.

We noted that the transaction counts, upon which staffing needs were computed, did include the payment transactions from the payment fraud. DPSS was not able to eliminate these transactions from the payment authorization counts. However, we determined that these payments only constitute about 3% of total number of contractor issuances. Accordingly, we do not believe that the inclusion of these issuances in the transaction counts will have a material effect on the estimates of avoidable cost.

Assumptions

As previously indicated, the Board's motion instructed us to determine the cost of having two County employees approve all contractor payments authorized through the GEARS and to identify possible alternatives. Accordingly, we have developed cost estimates under three different options, each of which provides the County with varying levels of assurance that contractor authorized payments are valid. Under each of the options described below, the following is assumed:

- DPSS personnel would now perform the benefit payment approvals and any post reviews (i.e., monitoring) of benefit issuances.
- DPSS would begin utilizing centralized unit(s) where County personnel approving payments would receive copies of relevant case documentation from contractors, transmitted via various electronic media (i.e., faxes, e-mail, etc.).

It should be noted that the estimates of avoidable cost are conservative estimates of the minimum cost of performing the various options described above. For example, in calculating the number of full-time equivalent positions required under each option, it is assumed that approvals and/or monitoring reviews will take place on a continuous basis and that the actual review times will approximate the review times from the simulations performed to develop the estimated review times. To the extent reviews cannot be performed on a continuous basis, or actual reviews times are greater than the estimated review times, actual staffing needs may be greater than those assumed in cost estimates. It should be noted that DPSS believes that the implementation of either Option 1, or 2 will impact the timeliness of services to participants.

Estimates of Avoidable Cost

Option #1: Under this option, two County employees would be required to review and approve all contractor authorized payments. Since the approvals of provider authorized payments would take place at a centralized, off-site unit and case documentation reviewed would only be copies and facsimiles of original documentation maintained in

the case file, it will be necessary for County personnel to perform post monitoring reviews of 10% of all provider authorized payments. While this is the most costly of the three options, it provides the greatest level of assurance that contractor authorized payments are valid.

Option #2: One County employee would be required to review and approve all contractor authorized payments from a centralized location. In addition, County personnel would perform post monitoring reviews of 10% of all contractor authorized payments. While less costly than Option #1, this option still provides for County personnel reviewing and approving each contractor authorized payment.

Option #3: Contractor personnel would continue to approve contractor authorized payments, with no County involvement. County personnel would perform post monitoring reviews of 20% of all contractor authorized payments. While this is the least costly option of the three, it also has the greatest risk of undetected payment fraud associated with it since County personnel would review only one of every five payment authorizations. In addition, detection would occur after the fact as part of the County's monitoring of contractor payments. Table 1 lists the estimated cost of each of the three options.

Table 1

Estimated Cost of County Approvers/ Monitors by Option	
Option Number 1	\$1,890,276
Option Number 2	\$1,240,291
Option Number 3	\$160,214

Enhancements to the GEARS

Following the detection of the GEARS fraud, DPSS took action to make a number of enhancements to GEARS to help prevent future payment frauds from occurring. For example, GEARS now requires an approval by a supervisory or managerial level employee on all payments. Accordingly, any future attempts to issue fraudulent payments would require a collusive effort. Previously, if the dollar amount on certain payments was below a specified threshold amount (e.g., \$150 for transportation payments), no secondary approval was required. Our review of the GEARS fraud disclosed that most of the fraudulent benefit payments involved payments that were less than the threshold amount, which would have required supervisory/management review.

Other enhancements to GEARS include additional controls when payments are being issued on cases that are inactive. In a number of instances, the provider issued fraudulent payments by reopening inactive cases, changing the mailing address(es) where payments were issued, issuing benefit payments, changing the mailing address back to the original address and returning the case to inactive status. DPSS has now modified GEARS to require management approval of payment authorizations on inactive cases, regardless of the amount. In addition, GEARS restricts lower-level staff from accessing these cases. Previously, no management approval was required, unless the authorization amount exceeded the payment threshold discussed above.

We have reviewed the key enhancements made to GEARS, have verified that they are in place and functioning and have made some suggestions for additional enhancements that we believe collectively will significantly improve the system of internal control over contractor authorized payments made through GEARS.

**Cost Effectiveness of Contracting for
Case Management Services Under the RITE and GAIN Programs**

Implementation of any of the three options described above will result in additional County contracting costs. As Table 2 indicates, regardless of which option is implemented, it would remain cost effective to continue contracting for case management services under both GAIN Program contracts. However, because the contract cost savings associated with the RITE Providers is minimal, this contract would no longer be cost effective if your Board decided to implement any of the options presented above.

Table 2

	RITE Program (1)	GAIN Program (2)	
		MAXIMUS	ACS
County Avoidable Cost	\$ 8,343,990	\$11,827,397	\$16,102,293
Contractor Bid Price	\$ 8,292,755	\$ 9,524,419	\$13,197,492
Cost Savings	\$ 51,235	\$ 2,302,978	\$ 2,904,801
Cost of Implementing			
Option # 1	\$ 1,188,983	\$ 273,821	\$ 427,472
Option # 2	\$ 781,706	\$ 179,657	\$ 278,928
Option # 3	\$ 97,622	\$ 24,580	\$ 38,012

December 5, 2003

- (1) - County Avoidable Cost and Contractor Bid Price for RITE Program are for one year period.
- (2) - County Avoidable Cost and Contractor Bid Price for GAIN Program are for a two year period.

Other Programs

In addition to the RITE and GAIN Programs, we noted that DPSS' CalWORKs Stage 1 Child Care contractors and the Los Angeles Homeless Assistance Service Agency (LAHSA) also authorize County payments. DPSS' Refugee Employment Program (REP) contractors are scheduled to begin authorizing payments. We will be issuing a separate report to your Board outlining options for better controlling these payments, along with the associated estimated cost of each option.

If you have any questions, please contact me at (213) 974-8301, or have your staff contact DeWitt Roberts at (626) 293-1109.

JTM:PTM:MM

c: David E. Janssen, Chief Administrative Officer
Bryce Yokomizo, Director, Department of Social Services
Robert Ryans, Director, Department of Community and Senior Services
Audit Committee